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ENTERPRISE DEVELOPMENT AND MARKET COMPETITIVENESS (EDMC)

BUSINESS ENABLING ENVIRONMENT REFORM IN ARMENIA

STATUS REPORT/SUPPORT RECOMMENDATIONS

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INTRODUCTION

The Government of the Republic of Armenia (Government) has made a clear and expressed commitment to adopt more business-friendly policies. In this regard, the EDMC team is planning to support local stakeholders in the introduction of strategic business enabling environment (BEE) interventions to promote increased exports and private investment and to spur job creation in selected value chains. A streamlined BEE creates strong incentives for entrepreneurs, particularly SMEs, to expand their businesses. The project intends to support these reform aims by benchmarking performance on the quality of business regulation in Armenia and providing targeted and prioritized technical assistance to reform important BEE areas. Key intervention areas will be selected/ground-truthed on the basis of priorities identified through EDMC analysis and through focused discussions with private sector and NGO institutional actors, the donor community, and by relevant public sector interlocutors. Demonstrated commitment to reform on the part of relevant government agencies will be a major factor in the enabling environment reform prioritization process.

BEE interventions can be critically important along two dimensions: they can influence the entire economy or a number of major sectors within the economy (i.e., horizontal rules). For example, business registration regulations affect a wide range of sectors in the same manner. It should be noted that key "macro-level" enabling environment constraints may well impact as severely (or even more severely) on the competitiveness of selected value chains than do some VC-specific constraints. At the same time, specific BEE rules targeted towards specific sectors or value chains (i.e., VC specific BEE rules) can have a major impact on VC competitiveness. For example, inadequate sanitary and phyto-sanitary regulations can have a major deleterious impact on the export competitiveness of a range of agricultural and agri-business sub-sectors.

In this report, EDMC team has mainly focused on a review of BEE horizontal rules, with the exception of a separate chapter of this report which is dedicated to the food safety control system in Armenia. Once the process of value chain selection is completed, the EDMC team will expeditiously update this report to focus on a review of VC-specific BEE rules. In this updated report we also plan to analyze a number of additional critical BEE horizontal rules (such as labor market regulation), as well as to provide complementary analyses for issues covered in the current report.

PROTECTION OF FOREIGN INVESTOR'S RIGHTS

The Law on Foreign Investments of the Republic of Armenia (RA) places heavy emphasis on protection of foreign investor rights/lawful interests. The law also mandates national treatment of foreign investors[1], except that foreigner citizens and stateless persons may lease but not own land.[2] There are no restrictions or controls on foreign exchange accounts, invisible transactions, or

[1] According to Article 6 of Law on Foreign Investments the foreign investment legal regime in relation to such investments cannot be less favorable than that applicable with respect to Armenian citizens, enterprises, institutions and organizations.

[2] This restriction relates only to foreign natural persons and stateless persons. This restriction does not apply to businesses incorporated in Armenia which are owned by foreigners, since by virtue of their registration in Armenia such businesses become resident entities in Armenia.

currency transfers, and there are no repatriation requirements. By law, foreign investments cannot be expropriated except in extreme cases related to a natural disaster or state emergency, or based upon a court decision; and must result in proper compensation. The law also includes a grandfathering or "stabilization" clause, according to which in the event of amendments to the investment-related legislation, the legislation which was effective at the moment of implementation of investments shall, upon the request of a foreign investor, remain applicable during a five years period.[3] In other words, foreign investors are in effect guaranteed that for a period of 5 years the key investment climate parameters applied to them can be no less favorable than those which were in place at the time their investments were initiated. In addition, there are no prohibitions on exporting products and no legal restrictions as to the type of economic activities that foreign companies may engage in, except those prohibited or restricted (through licensing requirements) by the law to all businesses.[4]

Accordingly, in recent donor assessments, the legal framework for foreign investors is viewed as being one of the most liberal and successful among emerging market economies.[5] However, our review of the Law on Foreign Investments did identify a significant area of concern. According to this Law, foreign investment-related disputes between a foreign investor and the Republic of Armenia must be resolved in Armenian courts, through the application of domestic legislation. Other disputes, to which the Republic of Armenia is not a party, may be resolved by arbitration as well.[6] Thus, this Law restricts foreign investors from filing an action against the state in other jurisdictions, and thereby limits recourse to alternative dispute resolution instruments. It should be noted that the Republic of Armenia acts as a contractual party during major privatization and infrastructural development projects[7], which in turn can have a powerful indirect impact on VC competitiveness. Therefore, in order to improve the legal guarantee framework for foreign investors, it would be advisable to consider amending existing legislation in order to repeal the restriction on dispute resolution in international courts for commercial transactions involving the Republic of Armenia.

Although in general the foreign investment-related legal/regulatory framework in Armenia is well developed, widespread corruption, bureaucratic inefficiency and lack of judicial independence greatly hamper the transparency and legal clarity with which the enforcement system operates. This in turn imposes significant obstacles to adequate protection of private property rights and efficient/time-effective enforcement of contracts by the courts. Expert observers note that the professional capabilities of judges dealing with business disputes are grossly insufficient.[8]

Favoritism, corruption and rent-seeking activities among executive branch officials appear to represent the most serious impediment. A recent survey implemented by the Global

[3] Article 7, Law on Foreign Investments
[4] Article 14, Law on Foreign Investments
[5] American Bar Association - KPMG Armenia; *Investment in Armenia Introduction for foreign companies considering doing business in Armenia*; August 2009; page 11
[6] Article 24, Law on Foreign Investments
[7] The Republic of Armenia acted as a contractual party in concession contracts with mining companies and with the Yerevan Airport concessioner, and in the establishment of a trust-management contract with the trust manager of the National Post. In the past, at least in one known case the Government bypassed the aforementioned legal provision, when it litigated against the Greek telecom operator OTE by disputing the licensing provisions of activities of Armenia Telephone Company CJSC (Armentel) in the London commercial arbitrage court.
[8] American Bar Association - KPMG Armenia; *Investment in Armenia Introduction for foreign companies considering doing business in Armenia*; August 2009; page 11

Competitiveness Report (GCR) among business community respondents indicates that corruption and inefficient government bureaucracy constitute the biggest obstacles for doing business in Armenia.[9] The most frequently referenced categories of corrupt practice included irregular or "informal" payments related to tax collection, export/import clearance and licensing/mandatory certification approvals.

As a result, Armenia is ranked just 97rd in terms of protecting investors and 91st in terms of contract enforcement in the most recent Doing Business Report of the World Bank[10]. Across a range of major international competitiveness surveys, Armenia is continuously ranked at low levels in the following critical areas: "property rights protection[11]", "enforcement of contracts[12]", "judicial independence[13]", "bureaucratic costs[14]" and "control of corruption[15]". In recent times Armenia has scored particularly poorly in the International Property Rights Index[16] and the World Governance Indicators[17], reflecting key aforementioned policy/institutional constraints limiting the effective protection of investor rights.

CORPORATE GOVERNANCE

Among the key distinguishing characteristics of the corporate governance framework in Armenia are limited awareness of international corporate governance standards/practices, concentrated corporate ownership/control and an almost total absence of transparent corporate governance traditions. Thus in most Joint-Stock Companies ownership and senior management are virtually indistinguishable and there is wide-spread apathy on the part of minor shareholders.

The key law regulating the corporate governance legal framework is the Law on Joint-Stock Companies (JSC) which was adopted in 2000. The corporate legal governance framework was revised in November 2007 with adoption of the Law on Securities Markets. This law was primarily developed based on EU regulatory standards in this area. Moreover in 2010, the Government approved a comprehensive Code of Corporate Governance.[18] The Code provides a set of core best practice-oriented corporate governance recommendations, but it is only binding for state-owned enterprises. In 2011, the Government mandated JSCs in which 50% or more shares are owned by the state, to implement the provisions of the Code of Corporate Governance on a compulsory basis.[19] At a sectoral level much more significant progress towards modern governance standards

[9] World Economic Forum; *The Global Competitiveness Report 2010-2011*; Chapter 2.1. Country / Economy Profiles for Armenia; page 100-101
[10] World Bank / IFC; *Doing Business Report 2012; Armenia-Country Profile*
[11] The Heritage Foundation and The Wall Street Journal; *Index of Economic Freedom 2011* and Fraser Institute, Economic Freedom Network; *Economic Freedom of the World 2011 report* and Property Rights Alliance; *International Property Rights Index 2011*
[12] The Heritage Foundation and The Wall Street Journal; *Index of Economic Freedom 2011*
[13] Property Rights Alliance; *International Property Rights Index 2011*
[14] Fraser Institute, Economic Freedom Network; *Economic Freedom of the World 2011 report*
[15] The Heritage Foundation and The Wall Street Journal; *Index of Economic Freedom 2011* and Property Rights Alliance; *International Property Rights Index 2011*
[16] Property Rights Alliance; *International Property Rights Index 2011*
[17] The World Bank; *Worldwide Governance Indicators 2010*
[18] Government Decision N 1769-A of December 30, 2010
[19] Government Decision N 881-N of June 3, 2011

has been achieved in the banking sphere. Thus, the CBA has incorporated into law[20] significant changes in the corporate governance framework for credit institutions.

Major donor-supported analyses and rankings mechanisms[21] clearly underscore the need for major improvement in minority shareholder rights, conflict-of-interest, board of directors liability, and information disclosure guidelines and enforcement mechanisms; as well as the need to introduce transparent share registries open to the public. We will articulate specific recommendations on key reforms in the corporate governance over the coming months in a manner which is maximally relevant for our VC investment promotion work, as well as our direct equity investment activities through SEAF.

REAL ESTATE REGISTERATION

In general Armenia's real property registration regime is effectively aligned with international best practice, and provides a strong legal framework for mortgage transactions. As surveys conducted by the World Bank, Heritage Foundation, Property Rights Alliance[22] and other think-tanks indicate, Armenia has one of most effective operating institutional frameworks in the property rights registration area across all emerging market countries. The World Bank ranked Armenia in 5th place in its global ranking for ease of property registration[23]. Currently, the major obstacle for effective operation of property registries is not burdensome regulatory provisions, but rather administrative inefficiencies associated with corrupt practices in the registration system.

Armenian law requires that all real estate transactions, including lease contracts on work space, land etc., be verified by a public notary and registered in the Real Estate Cadastre.[24] Recently, the Government has pursued a plan for amending the RA Law on Notaries in order to simplify notary verification procedures for real estate transactions (ownership, lease, pledge, servitude, etc.) through waiving this requirement for certain real estate transactions. In addition, the proposed amendments would facilitate introduction of an e-notary system and mandate establishment of and transparent public access to an electronic real estate cadastral and mortgage rights registry.

[20] Law on Banks and Banking, Law on (Universal) Credit Organizations and Law on Central Bank of Armenia are key laws that establish the corporate governance-related legal framework for credit institutions.

[21] The World Bank; Report *on the Observance of Standards and Codes (ROSC); Corporate Governance; Country Assessment: Armenia;* April 2005 and USAID Securities Market Strengthening Activity*; Macroeconomic and regulatory obstacles in development of securities market in Armenia*; Yerevan; 2006 and EBRD; "Law in transition"; *Strengthening corporate practices*; 2006

Note: Even though the above mentioned reports were developed during the mid-2000's, the issues raised in these reports have not yet been fully addressed by Armenian legislators; with the exception of the adoption of non-binding Code of Corporate Governance. Most importantly, no changes have been made in the Law on Joint-Stock Companies, the primarily law that sets forth governing rules for public (included listed) and private corporations (joint-stock companies).

[22] Property Rights Alliance; *International Property Rights Index 2010*

[23] World Bank / IFC; *Doing Business Report 2012; Armenia-Country Profile*

[24] Article 135, Civil Code, and Article 5, Law on State Registration of the Right to Property

MOVEABLE PROPERTY REGISTRATION

In terms of Armenian law ownership, pledge and finance lease rights for certain types of movable property are subject to registration.[25] The policy objective behind regulating the registration of moveable property - specifically in relation to lending and financial leasing activities is to strengthen the protection of creditor rights by establishing a clear prioritization of pledge obligations on the part of the debtor. Within this context it is imperative that the registration system is publicly available and cost-efficiently accessible.

Armenia recently initiated a reform of the registration system for movable property. Specifically, a targeted reform in registration practices for motor vehicles was initiated in 2010 which led to the establishment of comprehensive rules on state registration of ownership, pledge and lease rights for vehicles. As a result, these rules are now in line with those applicable for administration of the real estate cadastre.

Currently the system for registering moveable property other than vehicles is somewhat fragmented. The registry of ownership rights for movable assets is controlled/operated by designated Ministries[26], while registration of pledge and finance lease rights over movable property is conducted by the RA Real Estate State Committee.

The creation of a consolidated electronic registry for all types of movable property subject to registration would be a major step towards best practice compliance in this area, and would ease the administrative compliance burden for businesses. It would also dramatically facilitate the use of moveable collateral for lending purposes by financial institutions, since it would virtually eliminate the endemic uncertainty which currently prevails regarding prioritization of pledge rights against loans.

FINANCIAL LEASING

Both entrepreneurs and donor organizations[27] have suggested the advantages of promoting financial leasing in Armenia through granting tax exemptions on the import of equipment for financial leasing or by stipulating accelerated depreciation guidelines for this equipment. Additional tax breaks might promote some temporary increase in financial leasing activities in Armenia, but would not address key constraints related to property registration shortfalls and lack of confidence in regulatory enforcement mechanisms; as well as lack of awareness of the potential benefits associated with financial leasing arrangements among SMEs, potential lessors and banks. In this regard, any subsequent efforts undertaken to promote further improvement of the legal/regulatory environment

[25] Pledge and finance lease rights towards vehicles, equipment, self-propelled construction mechanisms, railway vehicles, flying and floating apparatus and equipment, agricultural animals, agricultural equipment, tractors can be subject to state registration.

[26] The registry functions for machinery, equipment and their components are reserved to the Ministry of Economy; for self-propelled road construction, construction and other machinery-mechanisms, railway transportation means, flying and floating appliances – the Ministry of Transport and Communication; for agricultural animals, agricultural equipment, tractors, self-propelled agricultural machinery and chassis and their components – the Ministry of Agriculture.

[27] International Finance Corporation; *Armenia banking market development project – development of leasing industry*; Report by John B. Grimmett commissioned by International Finance Corporation for the Ministry of Economy of the Republic of Armenia; October 5, 2010; page 4-5

for financial leasing should be squarely linked to public awareness activities and dialogue with SMEs and commercial finance institutions.

Currently, two different definitions of financial leasing are utilized in Armenian legislation: one is provided in the Civil Code, and the other is laid out in the Accounting Standards of the Republic of Armenia (ASRA).[28] Even though such a practice is not uncommon internationally,[29] there is clearly room/need for regulatory clean-up to avoid dual interpretation of admissible financial leasing transactions by local banks. Most particularly, the financial regulator (Central Bank of Armenia) must ensure that banks are not restricted in providing financial leasing services, even if in some cases legally-defined financial leasing transactions could be interpreted as operating lease transactions by accountants. Ultimately, the definition of what constitutes an operating lease is an accounting concept and should not restrict the scope of legally structured financial leasing transactions.

With regard to financial leasing transactions, there is also scope for improvement in the taxation legal/regulatory framework (not related to the introduction of special tax breaks). Importers of certain categories of goods, including some which are frequently leased, are able to defer the payment of import VAT for up to 3 years provided they that do not transfer the goods to 3rd parties during the deferral period.[30] This provision limits the possibilities for local producers to directly purchase equipment (via loans or financial leasing facilities) from local distributors, but instead encourages them to import such equipment from abroad. At the same time, banks are reluctant to utilize lending and financial leasing facilities to support such activities, as long as the equipment under consideration has not yet entered the territory of Armenia. Therefore, it is highly desirable to place financial leasing on the same footing as capital asset purchase through direct importation of products; through allowance of VAT deferrals for equipment imported for financial leasing purposes.[31]

FINANCIAL REPORTING

With USAID assistance, in March 2010 Armenian Government finalized translation of and published a comprehensive set of International Financial Reporting Standards (IFRS), as elaborated by the International Accounting Standards Committee Foundation.[32] In addition, the Government has also

[28] Definition of a Finance lease in the ASRA corresponds to the definition in the International Financial Reporting Standards (IFRSs) and partially corresponds to the definition in U.S. GAAP. In compliance with ASRA, in the event that any one of the below mentioned conditions is met, the lease is considered to be a Finance Lease: (1) at the end of leasing period, the title of the leased asset is transferred to lessee, (2) the lessee has an opportunity to purchase the given asset at a price, which is expected to be significantly below the actual cost on the date of its purchase, and it is expected at the beginning of the lease , that the opportunity to purchase the property will be realized by the lessee, (3) the major part of the asset's useful service life is included in the leasing period, (4) at the beginning of the lease, the present value of minimum rents is at least equal to the actual cost of leased asset, (5) because of the leased asset's unique character, only the lessee is able to use the property without essential modifications

[29] United States Agency for International Development; *Legal Framework of Leasing in Armenia*; Submitted by Financial Sector Deepening Project to USAID - Armenia under contract No 111-C-00-06-00061-00; April 2008; pages 2-5

[30] Article 6.1, Law on Value Added Tax of Armenia

[31] International Financial Corporation; *Armenia banking market development project – development of leasing industry*; Report by John B. Grimmett commissioned by International Finance Corporation for the Ministry of Economy of the Republic of Armenia; October 5, 2010; page 15

[32] Government Decision N 235-N of March 11, 2010

approved a set of IFRS standards specifically designed for SMEs.[33] Accordingly, the Government laid out a compliance timeline extending out to 2012; and enacted differential IFRS compliance requirements across different types of organizations for accounting and financial reporting purposes.

The harmonization of Armenian financial reporting with internationally accepted reporting principles (IFRS), should have a significant positive impact on investor confidence; as information related to the financial status of the Armenian companies is provided in a more comprehensive, transparent and relevant format for financial and managerial evaluation and decision-making purposes. At the same time, a practical issue in this regard is that the transition to IFRS will likely impose cost-intensive financial management challenges to Armenian companies; as they attempt to align accounting and reporting practices with international standards, while maintaining "dual" books which help them comply with current Armenian tax laws (which are in important respects non-compliant with IFRS standards).

TAX TREATMENT OF RESEARCH AND INNOVATION EXPENSES

Considering the scope of the EDMC project, and the prospective implementation of a new tax reform support project by USAID/Armenia, we have refrained from a comprehensive analysis of tax policy reform priorities in this report. However, taking into account the particular importance of innovation-driven competitive enhancement efforts for the success of EDMC, we have undertaken focused research on the tax treatment of research and innovation expenses.

Interviewed businesses noted in this regard that existing tax rules and associated accounting practices discourage research and innovation activities. This viewpoint merits clarification. Businesses can recuperate costs associated with basic research and technical experimentation activities, but not across relevant timeframes and not for expenses strictly incurred to support innovation activities. More specifically according to current tax rules,[34] businesses can deduct all expenses made for scientific-research and testing-engineering work from taxable income for the year in which the expenses were incurred.[35]

The tax deduction provisions reviewed under this section clearly establish the government's commitment to promote research and development. However, since the law allows only for a straight-forward deduction from profit tax in the given year, without the possibility to carry over expenses to the following years, the beneficial tax treatment may not have the desired effect on young innovation-based businesses, such as hi-tech start-ups, research laboratories, medical device

[33] Government Decision N 1209-N of September 16, 2010

[34] Article 15, Law on Profit Tax, Government Decision N 677of June 3, 2002 and Instruction of the State Tax Service (currently State Revenue Committee) adopted by Order N 1-05/7-N of April 2, 2004

[35] According to point 1 of Government Decision N 677of June 3, 2002 such activities are defined as:
"-scientific research works include scientific research and development, which is intended for expansion and use of existing knowledge and achievement of new knowledge, including fundamental scientific research and applied science;
-testing engineering works include development of certain structures for an engineering object and technical system, development of technical processes."

engineering firms, etc., as these businesses would likely generate little or no profit during their initial years of operation.[36]

Another example is that expenses incurred by businesses in innovation activities[37] cannot be deducted from profit tax, as such activities are neither considered scientific-research nor testing-engineering works. The legal framework clearly states that scientific research and testing engineering works do not include the innovation activities.[38] Meanwhile, Law on Free Economic Zones establishes certain tax and customs privileges for the entities operating in free economic zones. These tax and customs privileges also apply to the entities engaged in innovation activities. However, the innovation-promoting entities which operate outside of free economic zones do not enjoy the same privileges. A possible avenue for future work in this area may be amending the legislation to extend tax and customs privileges to innovation-based businesses that are not based in free economic zones; while working at the same time to define innovation-enhancement activities in a manner which does not promote widespread tax avoidance activities.

TAX COMPLIANCE

The most prominent taxation-related burdens on businesses, especially SMEs, are not associated with taxation rates. Instead, businesses frequently note that existing tax reporting and overall compliance requirements are complex and extremely time- consuming.[39] SMEs that do not have sufficient resources to hire lawyers or tax consultants are most decisively impacted in this regard. It should be noted that very often the amendments to tax laws which are undertaken contain confusing or ambiguous language and subsequently require additional official clarification by the tax authorities. Such clarifications are usually provided post-factum and with significant delay, which can increase potential errors in the reports submitted by the businesses prior to the issuance of such clarifications. Another area of significant concern is the arbitrary requirements for advance tax payments imposed by the tax authorities. Anecdotal information suggests that this is a serious problem which is imposing a significant financial burden on SMEs.

At present Armenia is progressing with a comprehensive tax reform agenda, slowly achieving greater results and easing the tax burdens on businesses.[40] A recent EU report[41] lauds recent reform progress in this area, citing recent achievements related to development of a Consolidated Tax Code, introduction of e-declarations and incipient adoption of a risk-based audit system; while

[36] Providing the tax benefit as a research and development expense deduction from annual taxable income will likely not have the desired effect. The policy objective of promoting research and development would be better served by providing, instead of a deduction, a tax credit that would allow such expenses to be carried over and deducted from future income. Such an alignment of the rules would provide a real, tangible benefit and would promote the development of innovation-based businesses; it will also promote outside investment in innovation, as investors would have the certainty that the research and development expenses incurred by a business in its infant stages can be recuperated from future income.

[37] Innovation activities are governed by Law on state support to innovation activities

[38] Point 3, Government Decision N 677of June 3, 2002

[39] IFC/World Bank; *Report on the cost of tax compliance in Armenia*; 2011

[40] According to recent rankings (World Bank/IFC *Doing Business Report* 2012) Armenia made tax compliance easier for firms by reducing the number of payments for social security contributions and corporate income, property and land taxes and by introducing mandatory electronic filing and payment for major taxes.

[41] European Commission; *Implementation of the European Neighbourhood Policy in 2009: Progress Report Armenia;* Commission Staff Working Document Accompanying the Communication from the Commission to the European Parliament and the Council; 12/05/2010

noting that work in other critical reform areas is still ongoing, such as reducing the endemic delays in VAT refunds.

Recommendations[42] made by donors active in the area of taxation focus primarily on streamlining procedures and improving governance incentives, including integrating tax and business registration ("one-stop shops") to reduce information and compliance costs; introducing specialized forms and tax reporting requirements and simplified tax accounting for small businesses; reducing uncertainty by introducing binding interpretations on tax laws and rulings; electronic filing of tax returns, payment reminders and special tax information for small businesses and newly-established enterprises.

Some of interviewed businesses also noted the endemic sluggishness in VAT refunds which has long characterized the VAT administration system. In this regard recent progress has been made: presently VAT refunds are reportedly being made within 90 days. Following recent amendments[43] to tax and inspections laws, taxpayers are eligible for automatic VAT refunds (without a tax inspection/review) based upon the application of risk criteria defined by the GOA.[44] Risk-based VAT refund processes have thus been introduced on step-by-step basis. Currently, automatic VAT refunds are provided for taxpayers who meet defined risk-management criteria, provided that the total monthly/quarterly amount subject to refund does not exceed AMD 5 mln. for 2011 and AMD 10 mln. for 2012. There are also amendments in place which provide for penalty payments to taxpayers for additional delays in payment of VAT refunds.[45]

CUSTOMS COMPLIANCE

Armenia's weighted average tariff rate (2.3 %) is among the lowest in the world. As a member of the WTO, Armenia has committed to apply tariff rates at the 0%, 5% and 15% levels for the entire range of imported products. No tariff rate quotas or preferential tariffs have been included in Armenia's schedule of specific commitments. In practice the Customs Code of Armenia has enacted tariff rates at 0% and 10% levels across all imports, with the exception of alcoholic drinks products. The latter group of products is subject to specific tariff rates. Armenia has no requirements for export or import licenses; however, for some products (e.g., dual use goods) businesses need to obtain a-priori permits for purposes of exporting/transferring these goods across the border.

As a key element of their institutional reform plan in this area, the Government is improving the customs clearance process by streamlining reporting requirements (clearance paperwork) and aligning associated procedures, and is promoting the use of electronic declarations. It is worth noting that in recent years, the Government has reduced the number of documents required for exportation by up to five items. However, a further decrease in number of days and procedures required for custom clearance of exported goods would clearly be advantageous in enhancing trade competitiveness, since the GCR ranked Armenia as one of the worst global performers in terms of

[42] IFC/World Bank; *Report on the cost of tax compliance in Armenia* 2011; page 17
[43] Amendments dated December 8, 2010 to Law on Taxes N HO-107 of 14.04.1997
[44] Government Decision N 1758-N of December 30, 2010
[45] Government Decision N 85-N of February 10, 2011 on the calculation and payment of fines for delayed payment of VAT refunds.

the "Burden of Customs procedures," ranking Armenia 131st out of 133 countries.[46] Donors are currently working to support development of a modern risk management system and to help improve the best practice compliance capacities of customs administration bodies.[47]

Armenia's reform efforts in the customs area are guided by the Customs Administration Strategy 2008-2012 (based on EU Customs Blueprints). Recent progress in implementing the strategy has included enactment of amendments to laws and regulations on customs brokers, customs control, simplifications of customs clearance, selectivity channels for border crossing points, a delayed payment and bank guarantee mechanism etc.[48] EU Advisory Group has noted in a recent report[49] that harmonization with the EU Customs Blueprint is still ongoing, and highlights a number of areas of needed improvement. These include further strengthening core customs administration functions to ensure that their efficient performance is not compromised following the merger of customs and tax administration authorities, and fully and effectively implementing a risk analysis system for post-customs clearance and audit.

A key focus of donor assistance in the customs area is strengthening the ethical standards and accountability of customs officials,[50] as well as providing procedural training of customs officials across a range of core functions. Based on initial review it appears that these remain critically important issues: interviewed businesses, exporters and NGO's active in export promotion[51] note that the most pervasive business-crippling constraints imposed by the customs regime are those associated with the discretionary interpretation of core customs procedural requirements.. At its core this phenomenon appears to be traceable to the "vagueness" of core customs regulatory/procedural guidelines, which in turn allows significant scope for interpretation by individual customs officials. Businesses note that this "vagueness" has generated a myriad of diverse and sub-optimal enforcement practices, which in turn has created an environment of endemic uncertainty regarding the treatment of goods – most particularly for imports – by the customs authorities. A related strong perception of businesses is that this regulatory environment breeds rampant rent-seeking behavior and corrupt practices. It appears in this regard that customs officials apply different clearance procedures for analogous import shipments.

Reference Prices

Interviewed businesses stressed that Armenian customs officials are constantly using reference prices on imported goods, rather than invoice prices, to calculate and levy customs duties.

[46] World Economic Forum; *The Global Competitiveness Report 2009-2010*; Chapter 2.1. Country / Economy Profiles for Armenia

[47] As Armenia is negotiating a DCFTA with the EU[47], a precursor to EU association status, the EU has been very proactive in their assistance efforts. As a precondition for initiation of DCFTA negotiations the EU requires Armenia to fulfil key institutional realignment conditions, including harmonizing its regulatory frameworks with EU requirements in the areas of Trade Facilitation and Customs Administration.

[48] European Commission; *Implementation of the European Neighbourhood Policy in 2009: Progress Report Armenia;* Commission Staff Working Document Accompanying the Communication from the Commission to the European Parliament and the Council; 12/05/2010

[49] EU Advisory Group; *Update on progress towards possible negotiation of DCFTA*; Draft (unpublished); September 2011

[50] In conversations with EU advisors it was noted that measures to improve ethics and integrity in customs, such as the recently approved Code of Ethics and establishing a Complaints Committee and associated complaint hotline has had limited impact so far.

[51] EDMC completed a round of interviews with business owners, NGOs and association representatives in the period mid-September-mid October 2011

Importantly, this practice appears to be applied with endemic frequency for the treatment of a range of technical equipment and inputs for the information technology and telecommunications sectors, thus hampering the development of high value-added innovation-based industries.

According to the Customs Code, the value of goods for import should be determined based upon: a) actual transaction price, b) transaction price of the same goods, c) transaction price of similar goods, d) price of the goods sold in the internal market (reference price), e) calculation of the price of parts or materials of which the good is composed (calculation value) and f) reserve method according to GATT principles.[52]

The primary valuation method – the transaction price - is defined in Article 87 of the Customs Code. Articles 88 though 93 define supplementary/secondary valuation methods for imported goods. The Customs Code and a related Government Decision explicitly postulate that each sequential valuation method can be applied only after exhausting the previous valuation method. So, by virtue of the law, reference prices should be applied strictly as a last resort, only after exhausting the other (previously stated) valuation methods and only if it impossible to establish the customs value using other referenced customs valuation methods (principally the invoice-based price of the good) defined by law.

The Government appears to recognize the urgent need to improve the customs valuation process. To this end, it is expected that revamped rules will be introduced whereby customs officials will be required to provide justification for not accepting the transaction price of traded goods, as set forth by Article 87 of the Code. The Government also plans to introduce enhanced statistical tools for collecting data on the types of cleared goods, and the value and quantities thereof.

Rules of Origin[53]

Best practice-consistent rules of origin guidelines are critical for purposes of determining which goods are subject to quantity restrictions, anti-dumping measures, tariff quotas, etc. (non-preferential treatment), and which goods are traded between particular countries at a reduced or zero rate of customs duty (preferential treatment).

Armenian exporters are not required to present Certificates of Origin to Armenian custom authorities during customs clearance. However, this document is often compulsory during custom clearance in export destinations. Within this context, certificates of origin are required to benefit

[52] Articles 87, 89- 93, Customs Code of Armenia

[53] In this chapter we have discussed the imperfections of export related certification of origin regulatory field in Armenia. In a manner that foreign countries require from Armenian exporters certificates of origin issued in Armenia, Armenian government requires from importers certificates of origin issued in foreign countries. Armenia's current rules of origin[53] applicable to imported goods, both preferential and non-preferential, have been vetted by the WTO, whereby in order to obtain preferential treatment, the imported goods must be wholly obtained in the country with which Armenia has a special trade relations. In cases where imported goods have been produced in more than one country "the country of origin shall be deemed the country where the goods have been sufficiently processed last" or where the value added in country exceeds 30% of the final value of the good. The government agency responsible for verifying certificates of origin and investigating the origin of goods without a certificate is the State Revenue Committee (SRC). Concerns exist as to the ethic commitment and knowledge capacity of the SRC to properly implement these rules; however, significant reform progress in this area is expected as a result of the preparations for negotiations of the DCFTA with the EU.

from the GSP+[54] policy of EU countries. In this regard the Chamber of Commerce and Industry of Armenia (ACCI) is authorized to issue certificates of origin.[55] The ACCI issues certificates of origin exclusively based on a testing protocol provided by its own subsidiary company – "Armexpertiza" LLC.[56]

In 2010 the Government introduced major changes aimed at reducing costs, shortening the timeframes and increasing the transparency of procedures for issuance of certificates of origin.[57] A further key step of the reform process in this area is the introduction of an electronic application system for certificates of origin. Pursuant to a recent Government Decision, ACCI has already developed a Technical Proposal for development of this system.[58] In fact, currently ACCI already accepts electronic applications via email; however, it is anticipated that the newly created electronic system (including website) will create a more sophisticated and transparent environment for application and issuance of certificates of origin electronically. In addition the Government decreased the costs, simplified procedures (waiving the requirement for expert examination of the basis for certification) and shortened the timing for issuance of certificates of origins for agribusiness products, as well as for products which had been certified at least once in the past.

The procedural framework for certification of origin contains two core methodological practices: certification in accordance with presented documentation and certification based upon expert examination. The ACCI issues certificates of origin exclusively based on a testing protocol provided by the "Armexpertiza" LLC, a subsidiary company of the ACCI. Based on comparative analyses of legal provisions, it appears that ACCI has the right to appoint different agencies to implement the aforementioned examination, thus creating a more competitive environment in this field.[59] In addition, existing regulations do not prohibit the delegation of examination function in the rules of origin area to independent companies (i.e., entities not affiliated with ACCI). However it does not appear that significant progress towards "opening up" the examination/certification function has been made thus far. In addition, EU-funded research[60] has underscored the importance of empowering a Government Agency with the responsibility to verify information to customs authorities abroad concerning the origin of exported goods based on specific written requests from foreign officials.[61] Because EU markets are a natural avenue to improve Armenia's export performance (including through more intensive utilization of the GSP+ scheme) it is also advisable to undertake a deeper assessment of Armenia's institutional compliance capacity with EU requirements in this area for the sub-sectors EDMC will be working with.

[54] The EU's generalized system of preferences (GSP) provides developing countries preferential access to the EU market through reduced tariffs. GSP is a formal system of exemption from the more general rules of the WTO.
[55] There are three types of the Certificate of Origin: (1) Usual Form, (2) CT-1 for CIS countries; (3) Form A for EU countries.
[56] The certification process is regulated by the Law on the Chamber of Trade and Industry, Government Decision N 1772-N, dated on December 30, 2010 and international multilateral treaties (for example with CIS countries)
[57] Government Decision N 1772-N, dated on December 30, 2010
[58] http://www.armcci.am/files/Havastagreri_tramadrman_elektronayin_hamakarg.pdf
[59] Article 6, Law on the Chamber of Trade and Industry and Points 12-16, Government Decision N 1772-N, dated on December 30, 2010
[60] Armenian-European Policy and Legal Advice Centre; *Increasing the Efficiency of the European Community GSP Utilization in Armenia;* Yerevan; page 4
[61] In general, the EU is actively involved in consulting with the Government on improving rules of origin-related guidelines, in order to assist local producers to fully benefit from EC GSP+ access and to ensure compliance with EU procedural requirements in this area.

INTELLECTUAL PROPERTY RIGHTS

In 2002 upon its accession to the WTO, Armenia committed to application of core provisions of the WTO Agreement on intellectual property rights (IPR) protection, without recourse to a transitional period. This was an ambitious commitment; and one which in practice has yet to be effectively implemented.

During the course of last eight years Armenia has enacted a number of laws that regulate each major category of intellectual property. The Criminal Code was amended with the aim of enacting severe penalties for infringement of core IPR rights. The Customs Code contains provisions on control and supervision over IPR-related inspection activities during customs clearance procedures. All of this serves to underscore that the Armenian legislative framework in the field of IPR protection has evolved in a manner which is largely consistent with WTO and WIPO agreement provisions.

However, despite expansive legal protections, violations of IRP rights appear to be common practice.[62] As noted by donors and NGOs active in the area of IPR protection, the true problems lie in the enforcement area, even though the relevant legislation provides for adequate instruments to penalize IPR infringements.[63] Under the Criminal Code of Armenia IPR infringements can be punished by substantial fines and imprisonment[64] The State Commission on Protection of Economic Competition (SCPEC) also plays a role in enforcement of IPR rules. Some IPR infringements are considered acts of unfair competition and are subject to fines on that basis as well.[65] Commercial litigation and associated compensation claims represent an additional potential avenue for deterring IPR violations; – according to law all proceeds generated from the use of the infringed IPR should be provided as monetary restitution to the IPR owner.

The lack of adequately trained staff of the Police of the Republic of Armenia and a pervasive lack of willingness on the part of public authorities to enforce IPR rules represent the principle reasons for ineffective supervision and enforcement of major IPR protections. A critically important reform action in this area would be to develop the necessary regulatory amendments and related implementation guidelines to facilitate comprehensive and expeditious restitution of income generated via IPR infringements in commercial disputes; either through direct litigation decisions or through mandatory arbitration processes.

[62] According to "*Investment Climate" Statement Armenia" publication released by the* U.S. State Department, Bureau of Economic, Energy and Business Affairs *"Armenia's legislation is in compliance with the Trade Related Aspects of Intellectual Properties (TRIPS)"*

[63] Anecdotal information suggests that there is an endemic tendency to stall prosecution of IPR infringements. Thus, only 20-30 cases on IPR infringement are investigated by Armenian authorities annually. The Cassation Court (the final instance court) of Armenia so far has examined just 10 cases of IPR infringement.

[64] According to Article 158 of the Criminal Code of Armenia the illegal use of copyrights or authorship carries with it a fine of up to 1000 times the minimum salary, or alternatively a one-year term of imprisonment. While the same fine is applied in the case of illegal use of trademarks the period of imprisonment is shorter (3 months); whereas in the case of illegal use of copyrights by an organized group (conspiracy), and in cases involving patent infringement, the fines and imprisonment period are doubled.

[65] According to Article 36 (5) of the Law on Protection of Economic Competition acts of unfair competition are subject to fines in the amount of "1% of the revenue gained during the year preceding the act of infringement."

COMPETITION

Competition law is a topic that has generated significant ongoing donor attention in Armenia, reflecting the gross inadequacies in the legal/regulatory framework which have traditionally characterized this area. It is common knowledge that competition in Armenia is severely muted, and in some instances virtually eliminated, in certain business sectors through skewed/discriminatory application of tax, customs valuation and trade-related regulatory guidelines/rules.[66]

In Armenia, free economic competition is a constitutional right,[67] and the legislative backbone for protecting and encouraging free competition and promoting entrepreneurship is established under the Law on Protection of Economic Competition of 2000, complimented by provisions contained in other laws[68] and the resolutions[69] of the State Commission on Protection of Economic Competition (SCPEC). Pursuant to the Law, the objective of the SCPEC is *"ensuring a favorable environment for fair and free competition"* and *"preventing, restricting and safeguarding against anticompetitive practices."*[70] Within this context, the SCPEC is tasked with designing and implementing policies and undertaking compliance actions aimed at preventing unfair competition; and monitoring and reviewing laws, policies and institutional behavior that run contrary to these objectives, including policies and government actions that are not consistent with the promotion of fair competition and may in some way themselves promote dominant behavior in the market place.

Key areas of concern in this area include the clarity/analytical quality of core legal provisions, as well as the capacity of the SCPEC to enforce them.[71] In this regard while some observers note that problems associated with enforcement are based on inadequate implementation capacity/bureaucratic will[72], others note that the vagueness and uncertainty characterizing the core

[66] According to "*Investment Climate" Statement Armenia" publication released by the* U.S. State Department, Bureau of Economic, Energy and Business Affairs *"Major sectors of Armenia's economy are controlled by well-connected businessmen—-some of them members of Parliament or with other government positions-—who enjoy government-protected monopolies. This raises barriers to new entrants, limits consumer choice, and discourages investments by multinational firms that insist on partnering with politically-independent businesses. The [Government of Armenia] also continues on occasion to deploy government agencies, including the tax and customs services, against political opponents."*

[67] Article 8, Constitution: the "Republic of Armenia guarantees freedom of economic activities and free economic competition"

[68] Article 12 (1), Civil Code of Armenia: The "use of the civil law rights for purposes of restriction of competition, as well as abuse of dominant position in the market is not allowed".
Article 195 Criminal Code of Armenia, defining criminal penalties for artificial increase, or decrease, or maintenance of illegal monopoly prices, restriction of competition through anti-competitive agreements aimed at dividing of the market based on territorial principle, restriction of entry of other entities to the market, setting up of discriminatory prices.

[69] SCPEC Resolution N 190-N of May 23, 2011 "On approval of the procedure on defining of the borders of the commodity market"; SCPEC Resolution N 194-N of May 23, 2011 "On approval of the procedure for determining monopoly or dominant position of legal entities, including market power, and criteria for such determination"; SCPEC Resolution N 195-N of May 23, 2011 "On approval of the procedure for reporting by monopoly and dominant legal entities."

[70] Article 19, Law on Protection of Economic Competition

[71] UNCTAD Secretariat; *Voluntary peer review of competition policy in Armenia*; 2010; page 11: *"The flagrant disregard for the merger notification requirement must inevitably generate damaging questions regarding the credibility of SCPEC – in effect a major provision of the Act is simply not being honoured."*

[72] EBRD; *Commercial Laws of Armenia;* July 2009; page 3: *"The gap between the quality of the law on the books and how those same laws work in practice (the so-called "implementation gap") undermines both the utility of specific laws and diminishes the confidence that both Armenians and foreign investors and traders have in the legal system."*

norms for establishing unfair competition, as crafted, represent the most crucial constraint on efficient enforcement of the competition-related legal regime.[73]

Some definitions provided in the law, such as those related to (1) collusive behavior, (2) acts constituting unfair competition, and (3) anti-competitive agreements, contain unclear/vague definitional criteria and are quite difficult to transparently and consistently interpret. In addition they appear to comingle unfair competition guidelines and criteria with violations in other areas, such as consumer protection rights.[74] An area of urgent assistance is thus to refine the legal definitions related to establishing unfair competition conditions by redefining them in a manner which promotes analytical clarity/precision, and which provides clear and transparent evidentiary guidelines which eliminate the rampant uncertainties currently associated with interpretation of relevant regulatory and procedural guidelines. Another example of such misguided codification is that de-*facto* businesses are encouraged to apply to the SCPEC for approval of the prices they intend to charge. Article 5 of the Law enumerates actions that would fall within the scope of anti-competitive agreements to include those that promote *"unjustified increase, decrease or maintenance of prices."* Under the same provision businesses can request the opinion of the SCPEC whereby the SCPEC determines whether the contemplated action (for example a price increase) is unjustified and could be interpreted as constituting an anti-competitive action. As noted by observers, this role *"clearly falls outside jurisdiction and functions of the competent authority (i.e. SCPEC), which is not a price regulator."*[75]

In 2011 based on donor recommendations the SCPEC tightened regulatory guidelines for defining monopolistic or dominant position for an economic entity,[76] the procedures for defining commodity market participants and boundaries,[77] and the procedures for determining/establishing merger & acquisition activities subject to a-priori reporting.[78] A further major reform action in this area would be enhancement of analytical tools and related procedural norms for effectively defining cases of abuse of monopolistic or dominant position, and establishing clear and transparent standards for anticompetitive (collusive) agreements. In this regard relying predominantly on a market share threshold as the core criterion to determine dominant position and may focus attention away from the most critical analytical issues; which related instead to assessing the actual impact of market behavior (pricing, sales, mergers…) on market competition conditions and performance.[79]

LICENSING

The Law on Licensing provides the backbone of the legal framework for licensing processes. It defines the type of business activities that require licenses,[80] as well as license-specific rights and

[73] UNCTAD Secretariat; *Voluntary peer review of competition policy in Armenia*; 2010; page 9: *"It appears that the rather unusual approach of the Armenian legislation has two origins, one explained by many years of price regulation, the other by a marked and much remarked-upon absence of investigative powers."*
[74] UNCTAD Secretariat; *Voluntary peer review of competition policy in Armenia*; 2010; page 15: *"The Law is not clearly drafted and it would be prudent to pay careful attention to existing samples of best or recommended practice."*
[75] UNCTAD Secretariat; *Voluntary peer review of competition policy in Armenia;* 2010; page 13
[76] SCPEC Decision N 194-N of May 23, 2010
[77] SCPEC Decision N 190-N of May 23, 2010
[78] SCPEC Decision N 191-N of May 23, 2010
[79] Many businesses operate in the 'shadow economy', whereas only a fraction of their operations are reported to the tax authorities in order to facilitate tax avoidance. Also, for a detailed discussion see: UNCTAD Secretariat; *Voluntary peer review of competition policy in Armenia*; 2010
[80] Business activities subject to mandatory licensing are listed in Article 43, Law on Licensing.

obligations.[81] Various government agencies are responsible for issuing different types of licenses. By law there are two types of licenses: (i) simple licenses which are issued under an expedited procedure involving a streamlined administrative approval process, whereby a license is issued within five days if the applicant meets set legal conditions; and (ii) more complex ("compound") licensing arrangements which entail multiple institutional review/approval steps, i.e., the licenses issued/rejected within a 30-day review period based on the expert opinion of the relevant Licensing Committee established in each license issuing government agency. Armenian law provides for a presumptive licensing regime whereby the licenses (both simplified and compound) are granted automatically if not disallowed within the defined time period[82].

The Government govern licensing in specific business areas, determine all procedural aspects/requirements associated with the licensing process, including issuance, required application documentation, licensee qualifications, the timing for license issuance etc.,[83] while the licensing authorities (i.e. the authorized government agencies) are the authorities responsible for suspension or termination of licenses.[84] A prime area of concern is that licensing committees play a highly discretionary role in the process; and that the procedures for selection of their members are not transparent.[85] After completing the process of selecting the value chains that will be the focus of EDMC support, the EDMC experts from the regulatory and value chain teams will carefully review licensing requirements and procedures applicable to business activities in the selected value chains and will develop recommendations for improvement or streamlining licensing as well as relevant permitting processes. We will also develop targeted recommendations to create more transparent selection and internal governance procedures for licensing committees.

In relation to government permitting requirements/procedures, there appears to be no overarching national legal/regulatory framework effectively in place in this area. This reflects the fact that most permits in Armenia are issued at the municipal level, although a few are provided also by Government Agencies[86]. Anecdotal information suggests that the financial costs associated with obtaining permits represent a significant burden on businesses, especially SMEs. This in turn appears to reflect the fact that the legal/regulatory framework does not require that the charge for permits be strictly tied to the cost of their issuance.

PUBLIC PROCUREMENT

The public procurement legal framework is established by the RA Law on Procurements[87] and secondary legislation adopted under the law. At present, public procurement actions are implemented in a decentralized manner. Each designated public agency has responsibility for

[81] Articles 7-10, Law on Licensing

[83] Government Decisions N 115-N of July 21 2005; N 774-N of July 2, 2009; N 237-N of July 28, 2005; N 1445-N of September 22, 2006.

[84] Article 8, Law on Licensing.

[85] Government Decisions N 115-N of July 21 2005 and N 1902-N of December 14, 2006 provide that the membership composition of licensing committees is subject to approval by Ministerial Order, but does not provide a coherent procedure for committee member selection.

[86] For example the Ministry of Economy issues permits for export and transit of 'controlled' goods (dual use goods).

[87] Law on Procurements, adopted in December, 2010 and in effect as of January 1, 2011.

organizing bidding and direct procurement to meet the needs of their organizations. The Ministry of Finance acts broadly as a policy-making institution in the public procurement area. The Procurement Support Center, under the Ministry of Finance, has primarily advisory and technical support responsibilities to facilitate sound implementation of procurement practices by Government agencies (such as provision of training and consulting services, publication of informational brochures, and creation and maintenance of a public procurement electronic platform). In addition, the Procurement Support Center has a regulatory function – to assess and approve the list of organizations prequalified for participation in bids for different categories of supplies. The Procurement Appeals Council receives appeals on procurement matters.

Article 7 of the RA Law on Procurement provides that tender-related documents can be developed, submitted and maintained in paper form, as well as in electronic format. However, detailed procedures for e-procurement have not yet been adopted. Note, that according to a recent RA Government Decision[88] the Ministry of Finance (the policy-making entity in this area) has been instructed to develop and submit procedures for e-procurement for Government consideration by October 30, 2011. The Government declared that the e-procurement system will be launched commencing 2012. In 2011, Armenia became one of a handful of developing countries which has acceded to the WTO Agreement on Government Procurement. In the next stage of the reform process the government is planning to harmonize its rules with EU public procurement directives and to focus on improving implementation of competitive public procurement practices.

A major area of concern, based in part on donor observations, is that there are no regulatory procedures which encourage or mandate strong SME engagement in public procurement actions. Another significant problematic issue is that the law establishes strict requirements on bid submissions, including documents to be attached with the bid application which, if not met, are automatic grounds for bid rejection.[89] The constraints imposed by this policy relate to the fact that the law fails to differentiate between substantive violations and purely administrative defects of bid applications. Such provisions allow a procurement agency to reject applications as incomplete, even if the deficiencies are only of a narrowly-defined administrative nature which do not impact in any material way on the viability of the proposal. Allowing bidders to amend their bid in order to correct minor technical/administrative defects may prevent procurement agencies from excluding potential bidders from the process based on technicalities, a practice which reportedly has been frequently used to influence the outcome of public tenders.

FOOD SAFETY

Legal and Institutional Framework

In 2010-2011 the Armenian Government implemented reforms designed to bring the public governance structure in the SPS area into conformity with EU member state standards. [90]

[88] Government Decision N 168-N of February 10, 2011
[89] Article 27 (5), Law on Procurements
[90] EU Member states generally appoint the following ministries and/or agencies as the competent authorities with responsibility for the implementation, control and enforcement of SPS legislation
- Ministry of Agriculture (responsible for policy drafting and implementation in broader SPS areas)

Accordingly, the Armenian SPS system is being reorganized from a multiple agency-based oversight system into an integrated SPS safety system with the lead role being played by the Ministry of Agriculture. Up until now, control over primary production was exercised by the Ministry of Agriculture, and control over processed food products was allocated to the Ministry of Healthcare; while control over the enforcement of food standards and over labeling and weights/measures were allocated to the Ministry of Economy.[91] One reason for the increasing involvement of the Ministry of Agriculture is the international trend towards establishing institutional oversight arrangements which help effectively address human, animal and plant health protection issues along the entire production chain. In addition, the Ministry of Healthcare is generally responsible for a large variety of other health-related issues, including healthcare, pharmaceuticals, tobacco control, and diseases; as well as for special-purpose food products.

Armenia is a member of major international treaties and organizations in the SPS area.[92] According to the EU[93]and World Bank,[94] the critical framework laws required for implementation of an EU-compliant policy in Armenia are essentially in place.[95] Those laws were adopted in conformity with Armenia's commitment under WTO agreements. EU funded research/analysis has revealed a number of discrepancies between the core SPS legal/regulatory framework in Armenia and EU standards. We learned during our interviews that the EU Advisory Group is advising the Government on development of a new Food Safety Law, to facilitate a higher level of compliance between Armenian and EU legislation which would help effectively address these discrepancies.

Up until 2005, Armenia's regulatory framework in the SPS and TBT areas was based upon 18,000 GosStandards, commonly referred to as "GOSTs". GOSTs were not harmonized with the standards of the International Standards Organization (ISO) or with European standards (EN). They also contained both mandatory safety requirements and voluntary product specifications within a single regulatory framework - a relic of Soviet times. When Armenia acceded to the WTO, the Government committed to mandate certification only for goods covered by safety-related technical

- Ministry of Healthcare (responsible for policy drafting and implementation for processed food-related safety standards)
- Food Safety Agency or equivalent (responsible for control and enforcement of SPS legislation)

Source: A.R.S. Progetti s.r.l. of Dialogue Consortium; *Support to the Government of Armenia for implementation of administrative capacities evaluation: Report on the assessment of institutional structure and administrative capacities in the field of food safety, veterinary and phytosanitary policy*; prepared by Karine Azatyan, Iren Melkonyan, Colm Halloran; page 36

[91] … page 34

[92] - CODEX Alimentarius Commission,
- Office International des Epizooties (OIE)
- European and Mediterranean Plant Protection Organization (EPPO)
- International Plant Protection Convention

[93] A.R.S. Progetti s.r.l. of Dialogue Consortium; *Support to the Government of Armenia for implementation of administrative capacities evaluation: Report on the assessment of institutional structure and administrative capacities in the field of food safety, veterinary and phytosanitary policy*; prepared Karine Azatyan, Iren Melkonyan, Colm Halloran; page 22

[94] The World Bank; *Armenia's Rural Economy from Transition to Development* ; August 2005; pages 10 and 56

[95] - Food Safety Law , adopted in November 27, 2006
- Law on Phytosanitary, adopted in November 27, 2006
- Law on Veterinary , adopted in October 24, 2005
- Law on Ensuring Sanitary and Epidemiological Safety of the Population, adopted in December 18, 1992
- Law on Standardization, adopted in November 9, 1999
- Law on Conformity Assessment, adopted in May 26, 2004
- Law on Trade and Services, adopted in November 24, 2004
- Law on Protection of Consumers Rights, adopted in June 26, 2001

regulations. Within this context, as of 2005 GOST, previously a mandatory technical regulation, became a voluntary requirement opening a huge regulatory gap.

For a long period, among the government agencies involved in human, animal and plant health protection field, the Ministry of Health was more advanced in developing health control regulations than other Government entities.[96] However, over the last few years the Ministry of Agriculture has also actively become more actively engaged in regulatory drafting activities.

The Government has approved a set of technical regulations in SPS area; including several technical regulations covering food safety control and a number of regulatory guidelines in the animal and plant protection areas. It now relies less on non-binding administrative notices – e.g., Orders of the Minister (for details, please, see the footnote bellow). These technical regulations address not only product standards but also standards for processing and production methods.

Despite the new regulations, there are few pressures to conform to international standards at present, as most trade in agricultural and food products follows traditional trading patterns and remains predominantly focused on the Commonwealth of Independent States (CIS) countries, for which national regulations have not been harmonized with international requirements (even in newly adopted compulsory regulations). In addition, anecdotal evidence suggests that in certain cases technical regulations of the Russian Federation have served as a basis for developing new technical regulations domestically.

Introducing internationally recognized food safety standards is an imperative in order to promote agricultural exports to high-value markets such as the United States and EU member states; and it is a necessity from a public health perspective as well. It will take considerable time for Armenia to assimilate International and EU practice and effectively implement the necessary domestic legislation. Over the last few years, the Government has undertaken several reform action steps to harmonize Armenia's technical regulations with international and EU standards:

- In 2006-2007, limited improvements were made in aligning local regulations with EU statutory provisions (package approach) by the EU-funded Armenian-European Policy and Legal Advice Center (AEPLAC)[97] project.

[96] Until now a number of regulations in SPS area have been developed and approved by the line Ministries. The rules approved by the Ministers are referred to as "Norms", whereas those approved by Government Decision are referred to as "technical regulations". Most particularly, the Minister of Healthcare has approved a number of such Norms related to the SPS area – Sanitary-hygienic norms. In practice, though the referenced norms are approved at the level of the Ministry they are still enforced on a compulsory basis. Taking into account local and international legal framework principles the compulsory enforcement of these norms is not immune from being legally challenged. It is essential to obtain Government approval for any mandatory regulation, because according to the Law on Legal Acts mandatory rules of behaviour (rights and responsibilities) of natural and legal persons can be regulated by the Laws, Government Decisions, Decisions of some regulatory agencies (such as the Public Services Regulatory Commission, State Commission for Protection of Economic Competition, Central Bank, others), but not by Orders issued by Ministers. This position is based on comparative analyses of Article 83.5 of the Constitution of Armenia and Article 9 (4.2) and Article 9 (4.1) and Article 19 (6) of the Law on Legal Acts.

[97] The Armenian-European Policy and Legal Advice Center coordinated the implementation of the National Program for harmonization of EU and Armenia legislation: In this regard over 50 national and international experts were involved in developing a comprehensive research facility to enable on-line screening, comparison, and final development of a detailed legal database comparing Armenian rules and regulations with the EU Acquis. Unfortunately, actual harmonization of local regulations with EU legal framework has been carried out only in few areas.

- As part of the EU-Armenia legal and regulatory harmonization exercise, the Government created the Translation Centre of the Ministry of Justice of the Republic of Armenia, with the mission to provide high-quality translation of Armenian laws and regulations in English and relevant EU legislation (*acquis communitaire)* in Armenian. (2008)
- Presently, the Government is adopting a step-by-step approach with respect to regulatory harmonization with EU requirements, whereby harmonization will be focused on designated food safety action plan priority areas.[98]
- A further step towards harmonization is reflected in a recent amendment to the law[99] which allows for standards and technical regulations written in English to be incorporated into Armenia's legal framework.

Donor assessments note that Armenian authorities lack the necessary knowledge and skilled staff trained on EU, WTO and international best-practices approaches to development and implementation of EU-compliant technical regulations/standards.[100] Regulations are mainly developed by government agencies, which rarely rely on expertise of other public and private sector stakeholders. Civil servants often lack English language skills, which contributes to their isolation with respect to global market trends and modern technical regulation-related policy making practices. In addition, there is also limited coordination among various Government agencies and private sector stakeholders in the process of regulatory development.

Areas of intervention by EDMC

1. Assist with the development of critical food and food product safety and animal and plant protection technical regulations (mandatory rules approved by the Government) and standards (optional rules) for production, handling, storage, processing, and distribution of agribusiness products for the selected value chains, leveraging existing government and donor efforts. The team can help ensure that new regulations are in compliance with international and EU technical regulations and standards.
2. In collaboration with other donor experts, support the government in designing and implementing a Regulatory Impact Assessment (RIA) pilot project for meeting internationally-recognized SPS requirements in selected value chains. Introduction of EU and international food safety-related technical regulations is a precondition for access to international markets. At the same time, introducing such stringent international standards is a complex, time and resource-consuming process. Rapid introduction of such standards could in some cases have a significant negative impact on current market players, as well as on potential market entrants. A gradual, carefully mapped-out introduction could allow the industry to adjust more smoothly and with a lower economic cost. A workable reform approach in this area could be to develop a coherent and multi-tiered strategy for crafting a

[98] It is currently envisaged that some of the legal drafting work under this regulatory harmonization program will be supported by the EU Advisory Group.
[99] With this amendment, the Government is seeking to establish a streamlined procedure for incorporation of international regulations into Armenia's legal framework. Accordingly, in 2008 the National Assembly introduced new amendments to the legislation, which enables the Government to approve regulations in foreign languages. See: Article 36 of the Law on Legal Acts.
[100] CASE; *Economic feasibility, general economic impact and implications of a free trade agreement between the European Union and Armenia*; CASE Network Report, No 80/2008; Warsaw; ISBN 978-83-7178-458-3; EAN 9788371784583; page 75

comprehensive policy and regulatory/procedural framework for the introduction of core EU food safety/quality standards in Armenia. This would entail a corresponding legal and economic analysis of the benefits and the counter-balancing public and private sector costs associated with introducing different types of food safety/quality requirements via the conduct of targeted regulatory impact assessment (RIA) analyses.[101] The end-result of that process would be recommendations for an appropriate tiering of food safety/quality requirements and standards for domestic producers and processors in a manner which would help ensure that core food safety standards are met for domestic consumers, while avoiding sudden unnecessary increases in production costs for local producers whom are producing for the internal market.

3. Assist Armenian SME's in meeting internationally-recognized SPS requirements for export purposes.
4. Facilitate establishment of a system of public-private consultation to encourage effective *involvement* of the *private sector* and other stakeholders (private firms, farmer associations, consumer groups and others) in preparing *draft technical regulations and standards in the SPS area.* This system will also contribute to strengthening the coordination among different Government agencies during the regulatory drafting process.
5. Support Government Agencies in strengthening human resource capacity for development and effective implementation of technical regulations and standards. Building the expert capacity of government personnel engaged in the regulatory development and compliance monitoring processes is essential for ensuring the continuity of critical reforms in this area.

Monitoring and surveillance (laboratories)

It is imperative that in addition to updating SPS technical regulation and standards, Armenia establishes modern mechanisms to monitor and enforce these new standards. In 2000, aligned with Government policies to improve the transparency characterizing state supervision in the SPS area, the control and enforcement functions of state agencies were segregated from examination and testing functions. These actions were aimed at increasing agency independence in the decision making process and in the monitoring and control of human, animal and plant heath safety. Inspectorates retained control and enforcement responsibilities, including the levying of non-compliance sanctions; while monitoring, research, testing, diagnostics, vaccine distribution, animal registration, and other similar activities in the field of human, animal, or plant health protection were passed to *de jure* independent State Non Commercial Organizations (SNCO).[102] However, due to

[101] Internationally RIA studies, or similar instruments, are used to support the political decision-making process and are instrumental in identifying and assessing regulatory and non-regulatory options for achieving the desired policy change, providing information on costs to businesses and the government in implementing the policy, and finding out whether particular sectors are disproportionately affected. Armenian law mandates that public bodies that develop legal drafts must conduct a "compulsory impact assessment of the regulation in terms of administrative expenses; environmental, social, healthcare and economic implications, including those for small and medium enterprise; and competition, anti-corruption and budget implications" this includes "[b]oth . . draft laws and draft Government decisions." Despite these legal requirements, the government has been quite lax in implementing this provision. To date, few legal acts have been subjected to an RIA study, and the studies that have been performed have been undertaken purely on an ex-post basis: reviewing the draft law/regulation after it has been approved; rather than conducting a study to analyze possible impact prior to defining the required regulatory change.

[102] SNCO is a type of legal entity. It is a type of non-profit organization whose sole authorized founder is the Government. Testing laboratories, diagnostic centers and scientific centers are SNCOs. Ministries and

limited voluntary testing requests from private companies, funding for the operation of these publicly-owned laboratories and testing centers continues to depend on the aforementioned Inspectorates. This results in the public laboratories and testing centers being closely linked to Inspectorates, which blurs the principle of separation of functions and decision-making independence.

At present, public laboratories and testing centers are under-funded, which prevents their modernization in terms of testing equipment; as well as hampering the proper alignment of monitoring and control capacities and technical skills with modern food safety requirements. Laboratories in the regions (marzes) and at the border posts are in dire need of modernization in terms of both personnel capacity and technical infrastructure.

Although most laboratories are public, there are some private facilities. An example is ExLab, a privately-owned laboratory with limited state participation, one of the few laboratories in the country with internationally-accredited ISO 9002 certification. Another privately-owned laboratory, Tonus Les, is currently under construction; however, its commercial viability requires further assessment.

In order to promote the growth of its agricultural exports, Armenian producers should have access to accredited laboratories capable of providing internationally recognized certifications for foods and beverages. Given that EU markets represent a natural avenue for increasing Armenia's agricultural exports, most domestic laboratories and testing centers require substantial improvements in order to meet Good Laboratory Practice (GLP) levels necessary to be recognized as a reference laboratory in the EU. This problem is not only export-related, but also raises public safety concerns, as existing laboratories lack both the equipment and expert capacity to monitor foodstuff and beverages produced in Armenia or imported into the country.

As a member of WTO, Armenia is committed to entering into agreements on mutual recognition of certificates of conformity and on unilateral acceptance of approvals (certificates of conformity) issued by internationally recognized conformity assessment bodies, e.g., inspectorates, laboratories, and testing centers.[103] However, so far Armenia has concluded agreements on mutual recognition only with CIS countries and Iran. Developed market economy countries have thus far not been prepared to reach agreement with Armenia on mutual recognition of certificates, citing the absence of internationally recognized conformity assessment bodies in Armenia.

Areas of intervention by EDMC

After selecting the value chains that are to be supported by EDMC, technical experts could conduct a laboratory capacity needs assessment for the selected value chains. Such an assessment should include:

1. Evaluation of local laboratory and testing capacities for products from selected value chains.
2. Overall evaluation of financing requirements for laboratory equipment upgrades to meet requirements for international ISO certification and GLP levels.

Inspectorates and other public institutions that are assigned to implement public administration duties are classified as State Executive Establishments (SEE). SEE do not have the status of legal persons, cannot provide commercial services and are only financed from state budget.

[103] Such mutual recognition practices are stipulated in EU directives

3. Identification of public laboratory upgrade opportunities through consolidation of public laboratories, staff reduction and operational cost downsizing.
4. Assessment of skills upgrading requirements for laboratory personnel.
5. Conduct of financial feasibility analyses with local exporters to assess the viability of using laboratory facilities in neighboring countries or the EU as a near-term alternative to development of additional testing infrastructure in Armenia. Based upon these findings, the EDMC team could support the Government in drafting the necessary regulatory framework reforms for mutual or unilateral acceptance of certificates of conformity, including those issued by internationally recognized conformity assessment bodies.

Official control (inspection)

In SPS area, including in the food safety control area, the following public agencies with inspection authority currently operate in Armenia:

- The Food Safety State Service (FSSS) of the Ministry of Agriculture is authorized to carry out inspection (control/enforcement) duties with regards to human, animal and plant health protection issues, including pre-market authorization procedures and market surveillance;
- The Hygienic and Anti-Epidemiological Inspection Service of the Ministry of Healthcare is responsible for the inspection of hygienic conditions for processed products, transportation, storage, marketing, and services (catering);
- The Market and Consumer Protection State Inspection Service of the Ministry of Economy is the core body authorized for the control of labeling and weights/ measures, as well as for compliance inspection for all types of products (with the exception of pharmaceuticals) with normative requirements at all stages of product handling – processing, storage, transportation, and final market disposition.

For many years food safety control responsibilities have been largely transferred away from the Ministry of Agriculture and Ministry of Healthcare and concentrated within the Quality Inspectorate (currently reorganized into the Market and Consumer Protection State Inspection within the Ministry of Economy). However, for past few years, the Government, following advice from the donor community (particularly EU-funded projects), has strengthened the responsibilities of the Ministries of Agriculture (currently through the Food Safety State Service) in the food safety control area. In cases where new regulations are needed to certify a product for export, developed countries will tend to recognize a competent authority based upon which agency appears to have the strongest current capacity. Thus, based on advice from the EC in Armenia control certification for live crayfish slated for export is made by the Hygienic and Anti-epidemiological State Inspectorate, though for other types of animal origin raw materials export and import veterinary certificates are granted by the Food Safety and Veterinary Inspection Inspectorate. This gives rise to complexities in the regulatory system that will eventually lead to multiple oversight coverage of the same processes by different Inspectorates and increased administrative cost-inefficiencies.

Inspectors frequently require companies to follow norms approved at the Ministerial level and sometimes even GOST standards. A major reason inspectors continue to behave in this manner is that public authorities have not yet enacted a sufficient number of compulsory regulations in the health protection area to effectively replace Soviet-era standards.

In 2009[104] the Government banned State agencies – with the exception of the State Revenue Committee - from carrying out inspections within SMEs.[105] The key reason behind this decision was the GOA's goal to promote the systematic introduction of risk based inspection (RBI) systems. The referenced Government Decision stipulated that the ban would be lifted as soon as an RBI system introduced by appropriate Inspection agencies was approved by the Council on Coordinating Inspection Reforms.[106] Anecdotal evidence indicates that this ban still applies to all inspections, indicating that none of the State Inspectorates have been able to introduce approved RBI systems thus far.

Areas of intervention by EDMC

1. After the value chain selection process is completed, expeditiously review all relevant inspection functions, eliminate the overlapping responsibilities of various inspectorates and those not relevant from a mandatory product safety perspective, in order to create the basis for an efficient and cost-effective system of food safety control.
2. Improve the quality and cost-effectiveness of inspection activities for targeted value chain through capacity development for the technical personnel conducting these inspections.
3. Support the formulation and implementation of efficient inspection procedures in for selected value chains; and facilitate the conduct and publication of related performance audits.

GMP and HACCP

There are no legal impediments to the voluntary introduction of Hazard Analysis and Critical Control Points (HACCP) in Armenia. The Law stipulates that the Government shall support companies in introducing HACCP.[107] Intending to bring Armenian legislation to compliance with EU statutory provisions, Armenian legislators went further by establishing mandatory requirements for Armenian producers to introduce HACCP for the purposes of securing food safety.[108] The timeline for introduction of HACCP as for food processing sectors is set out by Government Decision.[109] According to the established timeline, a number of sectors, including meat and meat processing, fish and fish processing, baby food and diet food production are required to introduce HACCP as of January 1, 2011. The timeline for HACCP introduction in other sectors varies from 2012 to 2014.[110]

While the timeline for introducing HACCP is mandated by government decision, businesses may introduce HACCP even before the established mandatory timelines on a voluntary basis. Good Manufacturing Practices (GMP) provides for sanitary and hygiene regulations necessary for the launching of HACCP. Within this context, businesses that introduce HACCP must have GMP in place as well.

[104] Government Decision N 594-N of May 29, 2009 and Government Decision N 1493-A of November 18, 2010
[105] This Government Decision defines SMEs as companies with annual turnover less than 70 million Armenian Dram
[106] Established by Government Decision N 1135-N of September 17, 2009
[107] Article 6, Law on Food Safety
[108] Article 6 (7), Law on Food Safety
[109] Government Decision N 531-N of May 3, 2007
[110] It is unclear how many of the businesses nominally required to introduce HACCP as of January 2011 under Government Decision N 531-N have actually done so.

TECHNICAL BARRIERS TO TRADE (TBT)

Legal Framework

As part of its WTO accession process, Armenia has agreed to comply with the Technical Barriers to Trade Agreement which ensures that standards, technical regulations, certification and conformity assessment procedures are not utilized as barriers to trade. In addition, the Government has committed to harmonize laws (in particular, technical rules and standards) and to promote the use of internationally accepted technical regulations and standards.[111]

Three major laws govern the technical barriers to trade (TBT) area: "On Standardization", "On Securing Uniformity of Measurement" and "On Conformity Assessment". The responsibility for implementing these laws is held by several government authorities: the Ministry of Economy, the National Standardization Institute, the National Institute of Metrology, the Certification Agency and the State Inspectorate for Protection of the Market and Consumer Rights.

The EU and other donors, notably the World Bank and the German Development Organization (GiZ) have been providing assistance for some time in the TBT area. A fact finding mission of the European Commission of 2009 revealed the following grey areas in the TBT regulatory sphere[112]: (i) technical regulations on industrial product safety are not yet harmonized with the respective EU regulations; and (ii) enforcement and application of laws on product safety is inadequate because the existing conformity assessment and market oversight institutional systems are underdeveloped and not capable of providing an adequate level of consumer protection.

In addition, the World Bank, in cooperation with German Metrology Institute (PTB) assessed the current situation of quality infrastructure and concluded: (i) organizations often grossly fail in efforts to promote sound application of contemporary quality practices; and (ii) the legal and institutional framework does not conform to international best practice. These factors result in severe deficiencies in national quality-related technical and oversight infrastructure.

The current system for developing and effectively implementing technical regulations has shortcomings as well. Technical regulations, to a certain extent, are based on EU Directives, but anecdotal information suggests that the regulations are frequently not observed because of the limited technical knowledge and capacity of the government experts involved.

To address these issues, the government has developed an action plan on harmonization in the TBT area. The plan takes a two pronged approach: (i) harmonization of domestic laws and regulations with EU technical legislation only in priority sectors and (ii) identification and progressive removal of restrictions on imported products, with a particular focus on removing technical barriers to trade deriving from differences between national technical regulations and EU-level technical requirements (including test and certification procedures). As a result of this approach, many national rules will inevitably remain in place outside the context of a coherent harmonization process for an extended period of time. Within this context it is critical for the government, working with the EU and other donors, to determine (i) the appropriate level of harmonization to achieve, e.g., standard equivalence, mutual recognition or full integration with EU standards; (ii) which product/sector areas

[111] Quality Infrastructure Reforms Strategy 2010-2020
[112] www.mineconomy.am/upload/file/Razmavarutun%20.pdf

to prioritize for the achievement of harmonization goals; and (iii) how quickly harmonization should be realized for those sectors.[113]

Recently, the Government has developed draft Laws on "Standardization", "Technical regulation", "Securing Uniformity of Measurements" and "Accreditation".[114] The drafts laws have been submitted to the EU Delegation for their opinion.[115] As the draft laws are released for public review, the EDMC team will analyze these and will work closely with EU and GiZ experts to develop necessary amendments, secondary legislation and implementation guidelines in the areas affecting the selected value chains.

Quality Infrastructure[116]

Quality Infrastructure (QI) [117] comprises the institutional network and legal framework for formulating, revising and implementing technical regulations and standards, [118] as well as the enforcement system that verifies compliance with technical requirements through a mixture of inspections, tests, certifications, metrology, and accreditation. The core goal of QI is to improve the technical adequacy of products, processes and services, thereby protecting the interests of consumers and businesses.

Armenia's QI institutional framework is implemented by the following institutions: the National Institute of Metrology of Armenia (NIM), the National Institute of Standards of Armenia (NIS), the Accreditation Agency (AA) and the State Inspectorate for Market Surveillance and Consumers Right Protection.

The metrology activities of NIM [119] are still based on GOST standards instead of International Organization for Legal Metrology (OIML) recommendations. Verifications are also not reliable because a rigorous traceability system does not yet exist.[120] Also, NIM is very dependent on the

[113] Full technical harmonization with EU requirements that would cover about 75% of the goods would include harmonizing Armenia's legislation with approximately 600 EU Directives. See: European Union Advisory Group to the Republic of Armenia Quarterly Progress Report 15 March – 01 June 2011

[114] Some aspects of the current law on accreditation from 2004 and the draft of the new law appear to generate conflicts of interest within the national quality infrastructure system, and do not correspond to either the internationally harmonized terminology or international guidelines and best practices. Thus the national accreditation body, the Accreditation Agency, has the status of a department within the Ministry of Economy - contrary to the requirement for political independence of a national accreditation body.

[115] Information available in RA Ministry of Economy website at: www.mineconomy.am/am/23

[116] Due to the inherently technical nature of the Quality Infrastructure area the findings in this section of the report are based in part on assessments and conclusions of the authors of *Upgrading the National Quality Infrastructure in the Republic of Armenia*" Report by the World Bank dated April 15, 2011.

[117] A quality infrastructure system is composed of many stakeholders, and interested parties, such as the government and its regulatory agencies; enterprises and business associations; calibration, testing, and clinical laboratories; consumers represented by consumer and environmental NGOs, academic institutions and institutes of research, development, and innovation.

[118] Standards and technical regulations are the formalized documentation that determines the requirements that a product, process, or service must comply with. Essentially, standards are considered voluntary. They become obligatory only if they are established within the context of a conformity agreement.

[119] The equipment of the NIM laboratories is out of date, and many of the measurement reference standards are not calibrated and, because of that, traceability is not ensured for all metrological parameters. Current facilities do not even meet domestic requirements in terms of condition, space, and structure and cannot conform to international rules requiring operation of separate laboratories for different quantities, such as mass, temperature, volume, and pH. *Upgrading the National Quality Infrastructure in the Republic of Armenia*" World Bank, April 15, 2011.

[120] The World Bank; *Upgrading the National Quality Infrastructure in the Republic of Armenia*"; April 15, 2011; page 12 "*Often the measurement equipment in enterprises is too recent to be verified by NIM's instruments and measurement methods; hence, in many cases, verification is only a formality".*

decisions of the Ministry of Economy and as a result has little effective autonomy. In addition, NIM does not engage representatives from the sciences and consumer protection organizations in important decision-making processes and in the development of legislation. As a result, the institutional capacity that Armenia does have in these areas is not being properly utilized at the moment.

Although the NIS is self-financed by its services,[121] it reports directly to the Minister of Economy. Contrary to international practice, it is neither the national standards body (NSB), nor the national conformity assessment body (CAB). MoE has both NSB and CAB roles.[122] In addition, again contrary to international practice, NIS does not develop technical regulations. These are developed by the line ministries (e.g., Ministry of Health, Ministry of Urban Development, Ministry of Agriculture); while the Ministry of Economy has supervision and control authority.

The AA meets none of the key criteria for a national accreditation body —political independence, technical competence, access and impartiality. Donors note that the accreditation process and the composition of the Accreditation Council do not correspond to international standards and that accreditation-related activities in Armenia resemble a state licensing procedure rather than a formal accreditation system/process. Identified short comings include: missing documentation on accreditation procedures, skill/experience shortfalls on the part of assessors; lack of transparent criteria for selecting members of the accreditation committee; absence of established criteria that would enable the Accreditation Council to set time limits for the accreditation process; and varying validity periods for certificates of accreditation. Other areas of institutional weakness in this regard include conflicts of interest in the appointment of experts to the Council, and the printing and recording of NIS certificates in a manner contrary to international practice.[123]

The State Inspectorate for Market Surveillance and Consumer Rights Protection concentrates on high-risk areas and products. At present, market surveillance of consumer and industrial products is close to non-existent, given the extreme shortfall in the Inspectorate's technical (in laboratories) and human resource capacity. As a consequence, a broad range of relevant products are not subject to monitoring/control activities.

There are no calibration laboratories in Armenia—only testing laboratories.[124] In most of the testing laboratories, the equipment is obsolete and conditions (e.g., air conditioning, humidity control, electricity supply) cannot be maintained and monitored with sufficient precision to ensure measurements with the desired accuracy. Additional areas of concern include: uncertain traceability chains because instruments are rarely calibrated; insufficiently trained staff (for purposes of effectively using laboratory equipment); and a virtual absence of well-equipped laboratories outside the capital. In addition anecdotal interviews indicate that laboratories sometimes falsify test results;

[121] The most important source of income for NIS seems to be product certification and the testing laboratory, which is linked to the certification service. Several national, private certification bodies operate in Armenia, but their capacity is said to be small, and their access to adequate laboratory facilities is limited. NIS therefore claims still to have more than two-thirds of the total product certification volume. Some complaints from the private sector claim that the testing and certification process is not transparent enough, the technical competence is doubtful, and the process is subject to corruption. Some entrepreneurs are of the opinion that more private certification bodies and testing laboratories are needed to end the quasi-monopoly of the NIS's certification body.
[122] *Upgrading the National Quality Infrastructure in the Republic of Armenia*" World Bank, April 15, 2011.
[123] *Upgrading the National Quality Infrastructure in the Republic of Armenia*" World Bank, April 15, 2011.
[124] World Bank; *Upgrading the National Quality Infrastructure in the Republic of Armenia*; April 15, 2011.

and finally it appears that overall there are an excessive number of laboratories considering the size of the country and the importance of effectively economizing on the availability of scarce technical and human resources *(please see EDMC intervention areas in SPS section above).*

The Government is taking some targeted action to address these issues. In its Quality Infrastructure Reform Strategy 2010-2020,[125] the Government has identified two major reform actions: (i) adopting a new legal framework in the area of technical regulation, market oversight, standardization, metrology, conformity assessment, and accreditation that is harmonized with international and European requirements; and (ii) revising the institutional framework (clarification of functions and authorities) for the quality infrastructure sector and supporting the related development of modernized new services. In addition, the government is updating the legal framework governing legal metrology, inspection and some aspects of consumer protection in the non-food sector.[126] These updates will introduce an EU-consistent approach to market surveillance—post-market monitoring and control *(please see EDMC intervention areas in the SPS section above).*

[125] The Strategy is approved by RA Government Decision N 1693-N of December 16, 2010.
[126] The Ministry of Economy is drafting amendments to the: Law on Conformity Assessment, Law on Metrological Control, Law on Consumer Rights Protection, Law on Inspections, Law on Administrative Offenses.

ANNEX — OVERVIEW OF DONOR ASSITANCE

Significant work has been done over the years to improve Armenia's business enabling environment and promote key export and economic growth value chains. Several donors provide assistance in areas that are relevant to EDMC. The assistance provided by EDMC experts will be carefully crafted to compliment the current and planned activities of various donor-funded projects.

After a round of meetings with representatives of donor-funded programs active in Armenia, several key players were identified:

European Union Advisory Group

As Armenia is negotiating a Deep and Comprehensive Free Trade Agreement (DCFTA) with the EU, a precursor to EU association status, the EU Advisory Group is very active in their assistance efforts. As a precondition to initiation of DCFTA negotiations, the EU requires Armenia to fulfill several conditions. The most important of these is to harmonize its regulatory framework with EU requirements in the areas of: tariff barriers; technical barriers to trade; sanitary and phyto-sanitary measures; trade facilitation and customs administration; rules of origin; services and investment; intellectual property rights; public procurement; competition; and sustainable development. The Armenian government has developed institutional reform plans in these areas.

Under its trade assistance component, the EU Advisory Group advises the government on sanitary and phytosanitary rules, eliminating technical barriers to trade, protection of intellectual property rights, trade and customs issues. The EU Advisory Group is also providing policy advice and budget support, including assistance to the Armenian government in developing legal frameworks – with a focus solely on the drafting and adoption of primary legislation, i.e. laws. EU-led assistance in developing secondary legislation (e.g., regulations, government orders, implementation guidelines/instructions) is provided under Twining Programs. There are currently Twining Programs in the areas of competition, food safety standards, customs reform, IPR, and RIA. These programs assist the Ministries of Economy, Agriculture, Health, State Agency for Protection of Economic Competition, State Food Safety Service, Customs Agency, Intellectual Property Agency, the National Institute of Metrology of Armenia, the National Institute of Standards of Armenia, the Accreditation Agency, the State Inspectorate for Market Surveillance and Consumers Right Protection, the Police and the Judiciary. EU support to Armenia's government in these areas is interlaced with assistance provided under the Comprehensive Institution Building assistance program, which is dedicated to building capacity in public institutions necessary for the DCFTA.

EDMC will closely collaborate with the EU Advisory group to assist the government to meet its obligations as defined under the Armenia-EU DCFTA, and to achieve legal approximation with EU law (*acquis communitaire*). Since the regulatory assistance provided by the EU Advisors will be dedicated to developing primary legislation, the EDMC team will focus on assisting the government in developing secondary legislation where relevant to the broader trade/investment facilitation purposes of EDMC; including regulations and instructions (implementation guidelines). EDMC plans to collaborate with the EU Twinning project advisors in these areas.

In the event that EDMC assists value chains in the area of food safety, EDMC could (as noted earlier) support the Government in designing/implementing an RIA pilot project associated with the

introduction of EU Food Safety Standards and Practices. Such an RIA exercise will help identify the socio-economic impacts of introducing strict EU Food Safety Standards. This includes costs to the government associated with introducing new standards and the compliance costs that will be imposed on businesses. With this information, the government can plan appropriate gradual implementation programs. This exercise will also allow businesses to increase their participation in the development the regulations (via the RIA public consultation stages); and help businesses determine the costs required to meet the EU standards, including costs for new processes and procedures, new production equipment, EU compliant packaging and transportation means, key supplies, and training.

German Development Agency (GiZ)

GiZ is actively involved in export and trade promotion. GiZ is providing financial and capacity building assistance to Armenian agricultural companies, primarily by helping these companies attend trade shows in Europe. GiZ experts are also providing technical assistance to the Armenian Development Agency.

GiZ is actively assisting Armenia to introduce EU food safety standards. It is assisting the State Food Safety Service to build capacity and sponsor trainings on EU food safety standards for employees of Armenian agricultural exporters, and for the expert personnel of laboratories active in the area of food safety. GiZ is also providing assistance designed to promote the harmonization of Armenia rules and regulations with relevant EU regulatory guidelines (*aquis communitaire*).

EDMC will work closely with GiZ experts in these areas, providing expert advice on policy development and helping to develop amendments to existing regulations as relevant to our broader trade/investment promotion and market linkage objectives at the value chain level.

International Finance Corporation (IFC)

The IFC is providing or plans to provide assistance in a number of key areas of investment climate reform; including improvement of Doing Business Report indicators, inspection reform, and tax administration reform. The IFC is also planning to contribute to the Regulatory Guillotine project initiated by the Government. The project is aimed at eliminating business-constraining government interventions and practices following a comprehensive review of business sector regulations.

A very close coordination of the efforts of EDMC and IFC is imperative to avoid overlaps and maximize the regulatory reform and institution-building impact of available assistance resources. Initial meetings with IFC representatives have created strong momentum for close collaboration between the EDMC team and IFC expert personnel share in effectively pursuing these shared reform objectives.

One likely strong point of coordination will be joint participation in working groups with the Ministry of Economy. In addition, as IFC program assistance is geared primarily towards changes in primary laws, with a predominant focus on tax and customs, business registration and construction permit issuance and inspection-related reforms; EDMC experts will likely focus their assistance efforts in complimenting these efforts by providing assistance on secondary legislation, regulations and instructions. It should be noted that because IFC programs are not focusing on licensing reform,

this is clearly a major area where EDMC could lead in cutting edge technical assistance to the government.

United States Department of Agriculture (USDA)

The Center for Agricultural and Rural Development (CARD) is focused on agribusiness and marketing, rural development, food safety and animal health. CARD is providing technical assistance under the USDA Armenian Food Safety System Project to improve core sanitary and phyto-sanitary standards for food safety, as well as to facilitate the export of Armenian food products globally. CARD is also active in the area of value chain development, specifically with respect to livestock (meat and dairy production), viticulture and wine making, and high values crops (e.g., corn, carrots).

EDMC experts could compliment the work of CARD in the areas of food safety standards, including in designing and delivering associated trainings and assisting the Government in meeting EU food safety requirements.

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